

## Section II Production

### Chapter 6

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### Participant Credit and Financial Review

#### 6.1

#### Determining Acceptability of the Borrower, Operator, Parent of the Operator, and the General Contractor

##### A. Overall Requirements

A key component of the underwriting process is to assess the Borrower and/or Operator's ability to manage the development, construction, completion and successful lease-up of the FHA-insured property. The underwriting of Section 232 projects involves evaluating the experience and financial condition of the Borrower and its principals, the Operator, parent of the Operator and the general contractor. The FHA lender (the "Lender") must:

1. Identify the Borrower, Operator, parent of the Operator, general contractor and each of their respective principals.
2. Analyze the credit worthiness of the borrower entity, and if formed, the principals of the borrower entity, Operator, parent of the Operator and the general contractor.
3. Analyze the experience and qualifications of the Borrower Operator, parent of the Operator and general contractor.
4. Determine the financial capability of the Borrower and the general contractor.

Take a wholistic approach to evaluating credit worthiness and assessing credit risks. ORCF expects the FHA Lender to inquire about and to bring to ORCF's attention any potential credits risks such as, without limitation, governmental investigations or instability in entity's management structure.

##### B. Terrorism Checks and Verifications

Terrorism checks and verifications on all principals are required by the USA Patriot Act. These checks must be completed and documented prior to Initial Endorsement of the FHA-insured loan, regardless of whether or not the Lender is a regulated financial institution. The Office of Foreign Assets Control of the United States Department of Treasury administers and enforces economic and trade sanctions based on US foreign policy and national security goals. Information and guidance on the requirements of the Patriot Act can be found on the Department of Treasury's website <http://www.ustreas.gov>.

- C. **Identifying principal ownership interest.** There are numerous ways for investors to own an interest in real property. Each form of ownership offers different benefits and risks. If the Borrower (and/or the Operator and parent of the Operator) has a complex or layered organizational structure, the Lender must review the structure and identify the individuals or entities that have control under the organizational structure. The Lender must confirm that the Borrower (and/or the Operator and parent of the Operator) is legally organized in a manner that meets U.S. Department of Housing and Urban Development's ("HUD") requirements for owning and operating an FHA-insured facility, and consider any difficulties or increased risk that the organizational structure might pose in the event of default or foreclosure on the FHA-insured mortgage loan. All principals that meet the ownership and control standards set forth in HUD's previous participation regulations must file a Previous Participation Certification Form HUD-2530) or APPS submission (see Production, Chapter 2) and are subject to the disclosure and certification requirements regarding bankruptcy, judgments, pending litigation and delinquent federal debt. Those principals with decision-making authority, active management roles, or a significant percentage of financial investment in the project are subject to a more complete credit investigation. The Lender is responsible for identifying the principals and the extent of the credit review required and appropriate for each such principal.

Each FHA-insured property must be owned by a single-asset entity unless another form of entity is approved prior to application submission (See Production, Chapter 2). The following types of single asset entities are acceptable:

1. General Partnership (GP);
2. Limited Partnership (LP);
3. Corporation, C corporation, S corporation;
4. Limited Liability Company (LLC);
5. Trust;
6. Non-profit corporation;

- 78  
79 7. Any other public or private single-asset borrower entity; however, the FHA-insured  
80 property may not be owned by a natural person or as tenants in common;  
81  
82 8. Any combination of ownership forms can be used to establish a joint venture, for the  
83 purpose of jointly sharing the risks and the rewards by contributing the appropriate  
84 knowledge, skills, or assets that are necessary for a successful development project.  
85 However, a single-asset borrower entity is always required.  
86

87 **D. Foreign national and corporate entity participation.** Generally, foreign nationals and  
88 corporate entities may participate as principals. However, the single-asset borrower entity  
89 must be registered in the United States in the state where their corporate office is located and  
90 at least one principal, with operational decision-making authority, must be a United States  
91 citizen.  
92

93 Where eligible to do so, foreign participants must obtain an international tax identification  
94 number (“ITIN”) from the Internal Revenue Service. Information on the process to obtain an  
95 ITIN is available at: <http://www.irs.gov>.  
96

97 **E. Identifying the principals:** A principal is a public or private entity proposing to participate  
98 in a project as a Borrower, Operator, parent of the Operator, Management Agent, general  
99 contractor or the like. A principal can have an active role in a project and direct the activities  
100 and affairs of the borrower entity or be involved in decision-making; or a principal can have  
101 a passive role where the principal’s participation is limited to an ownership interest in the  
102 project. All principals must be identified and analyzed based on their experience,  
103 creditworthiness and financial histories.  
104

105 **1. Principals:** “Principals” are:

- 106 a. The borrower entity, any entities and individuals with a significant ownership  
107 interest in the borrower entity (as described below), and any affiliate (whether  
108 individual or entity) of the borrower entity or any of the individual or entities with  
109 a significant ownership interest. For partnerships, all general partners are  
110 principals, and limited partners having a 25% or more interest in the partnership  
111 are principals. If the principal is a corporation, all operating officers, all officers  
112 of the board of directors, and each stockholder having a 10% or more interest in  
113 the corporation are principals, and all limited partners having a 25% or more  
114 interest in the corporation are principals. For non-profit corporations, principals  
115 include officers of the board of directors and any staff members who are  
116 designated by the corporation as corporate officers.  
117 b. All managers and managing members of LLCs are principals and all members  
118 that have a 25% or more interest in the LLC are principals. A member is an  
119 owner of the LLC and is similar to a stockholder in a corporation. A manager is a

person chosen by the members to manage the LLC and is similar to a director of a corporation. A manager can also be a member.

- c. General contractors.
- d. Management agents (*Note: the Lender does not have to conduct a financial and credit analysis of a management agent.*)
- e. Packagers, and other persons or organizations hired to furnish advisory services in connection with project financing, construction or operation are principals even if the services provided are limited to selecting and negotiating contracts with contractors, architects, attorneys or managing agents; or to negotiating contracts to secure financing for the project; and
- f. Consultants (except for architects and attorneys that are engaged in an arm's length cash fee arrangement to provide professional services for a project and who do not have an ownership interest or a management role, or who do not participate in other ways as a principal in the project).

2. **Non-principals:** Those who are not considered "principals" for purposes of credit and financial investigations are:

- a. Stockholders with less than 10% interest in a corporation;
- b. Limited partners with less than 25% interest in the partnership;
- c. Attorneys and architects with only an arms-length fee arrangement to provide services for a project;
- d. Minor corporate officers;
- e. Subcontractors;
- f. Brokers whose services are limited to referring the loan to a Lender and presenting information on behalf of the Borrower (provided that the services provided fall short of consultant or packaging services);
- g. Public housing authorities;
- h. Members of a non-profit's board of directors who are not board officers and do not have a decision-making role over the property;
- i. Officers of passive investors (e.g., pass-through/shell companies, tax credit investors, or syndicators);
- j. Management agents.

*Note: A determination of the principals of a trust requires an analysis of which individuals control the assets of the trust and what restrictions are placed upon them. Individuals who have effective control of trust assets should be treated as principals. The Lender Narrative should explain the Lender's identification of trust principals.*

3. **Liability:** Section 38 of the Healthcare Regulatory Agreement – Borrower (HUD-92466-ORCF), requires that individuals or entities who will be personally liable for certain enumerated matters be identified within the document.

- a. For privately held entities: Section 38 generally requires two signatures for

project sponsors. In most cases, HUD, upon the Lender's recommendation, shall select one individual signatory to sign in his or her individual capacity and the project parent/sponsor entity to sign in a corporate capacity. In any specific deal, underwriting may point to a different entity with the requisite control and involvement or interest in the Project, positive credit history, and adequate financial strength relative to the size of the loan to serve in the capacity required by Section 38.

- b. For publicly traded corporations or REITS, or Non-profit organizations: The parent/sponsor entity itself is acceptable as the sole signatory. For such entities, any individual signing on behalf of the corporate entity does not sign in an individual capacity, but to bind the parent/sponsor, and no personal liability will be claimed against the individuals signing in such a capacity.
- c. For any corporate entities required to execute Section 38: Every corporate officer is not required to sign. Whomever the corporation entity has authorized to bind the company in connection with the proposed transaction may sign, provided that ORCF, upon considering the Participant Credit and Financial Review, has discretion to require additional signatories if warranted in a specific (exception) situation.
- d. If state or local law requires these signatures to be notarized in order for Section 38 to be enforceable or for recordation purposes, then the signatures are to be notarized.
- e. Please note the following prohibitions related to Section 38:
  - i. Insertions of "or successors" language to the identification of signatories is NOT allowed. The Regulatory Agreement can and should be amended when there is a new individual who is responsible for the provisions of Section 38.
  - ii. Riders to the Regulatory Agreement that attempt to limit a signatory's liability are NOT allowed.
  - iii. Section 38 may not be omitted because a project has been processed as an (a)7 versus another section of the Act.
- f. It is the Lender's responsibility to perform the Participant Credit and Financial Review of the parent/sponsor entity and to identify and justify who has been proposed to sign Section 38 of the Regulatory Agreement.

**F. The credit investigation.** Lenders are required to obtain credit reports or credit histories in order to validate and check the information contained in the financial statements and application forms that are submitted by the Borrower. Credit reports give a picture of the Borrower's payment history and financial interactions with its creditors, and allow the underwriter to make sound conclusions about the Borrower's credit-worthiness. Credit reports also assist the Lender in reconciling any significant contradictions between the financial statements and the credit report.

A commercial credit report for a business or a residential mortgage credit report for

individuals must be current within 60 days of the application acceptance date and the Office of Residential Healthcare Facilities (“ORCF”) may require updated reports during processing. Credit reports are required on:

1. The borrower entity, if formed, before submission of an application.
2. Principals of the Borrower as defined in Section 6.1H above. *(Note: If a principal is a business entity, i.e., corporation, partnership, limited partnership, with an operating history, a credit report is required only on the business firm, not the owners or partners of the firm.)*
3. All businesses with pending judgment(s), legal action(s), lawsuits, or bankruptcy claims.
4. 10%, up to a maximum of 10, of the sponsor’s other business ventures as selected by the Mortgagee.
5. The facility operator.
6. The parent of the operator.
7. The general contractor.
8. The housing consultant, as applicable, for non-profit transactions.
9. A credit review of members of public and non-profit boards of directors is not required unless the board member is also a board officer with an operational decision-making role over the property.

#### **Lender’s review of the credit report.**

1. The Lender may obtain a Dun & Bradstreet or similar commercial credit report for business entities and a residential credit report for individuals. An acceptable commercial credit report should include public filings (lawsuits, liens, judgments, bankruptcies and federal debt; Uniform Commercial Code (UCC) filings; credit payment history; financial stress/payment trends compared to industry standards; and a credit payment delinquency risk score over a twelve month period.
2. The Lender should compare all information obtained from credit reports and credit histories to the financial statements provided by the relevant Borrower or principal(s). Any contradictory information should lead to further inquiry until the evidence shows a consistent and complete picture.



3. The Lender should make reasonable inquiries to determine if the applicant or any principal is in default on any federal debt (i.e., direct loans, FHA-insured loans, student loans, and Small Business Administration loans) or any judgment liens against the property for a debt owed to the federal government.
4. The Lender should determine if the information is incomplete, or if there are inconsistencies or discrepancies between the information included in the financial statements and the information in the credit reports and resolve those inconsistencies or discrepancies.
5. The Lender should investigate any adverse credit information that appears on the credit report or information that becomes known from making inquiries of bank and trade references and of other HUD offices. The Lender must require a written explanation of any late payments, adverse actions, judgments or other derogatory information.

**G. Delinquent federal debt:** When a delinquent federal debt exists, the Lender shall include as part of the required application exhibits:

1. a detailed written explanation from any applicant or principal with a prior federal default or claim or whose credit report and financial statements contain conflicting or adverse information.
2. a letter from the affected agency, on agency letterhead, signed by the appropriate agency officer, stating that the delinquent federal debt is current or that satisfactory arrangements for repayment have been made.
3. the Lender's reason(s) for recommending the applicant, which may be included in the Lender Narrative.

**H. Additional review:** In addition to the formal documents and credit investigation described above, the Lender's underwriter must conduct and describe the results of a thorough internet search of each principal and determine if there are any citations which raise concerns about creditworthiness of any principal.

**I. Rejection because of unacceptable credit.** The Lenders should use its professional judgment when approving or rejecting a principal based on the applicable principal's creditworthiness. The individual may be rejected if:

1. the credit investigation evidences that the principal has a history of not paying creditors in a timely manner or lacks liquidity.

2. any delinquent federal debt has not been resolved or satisfactory arrangements for repayment have not been made.
3. There are judgments or actions against the principal that:
  - a. could significantly impact upon the financial position of the individual/ firm or corporation.
  - b. result in a determination that the individual, firm or corporation is an unacceptable credit risk.
  - c. the principal is insolvent or is the subject of a pending bankruptcy or insolvency proceeding at the time of application, firm commitment, or at the time of loan closing. *[Note: The Lender should update credit reports or investigations at firm commitment and prior to closing]*

**J. Analyzing the Borrower, Operator, parent of the Operator and general contractor's previous experience:** The Lender's underwriter must evaluate the resume of each principal. Each principal must have proven experience and qualifications in developing, owning, or building health care facilities similar to the proposed project. The Lender should pay particular attention to:

1. the type and size of previous residential healthcare facilities in which the applicable principal has been involved and assess whether the principal's requisite business experience shows that the principal is able to operate and manage a residential healthcare facility of the size and complexity of the subject property throughout the term of the mortgage. For Borrowers on a property receiving LIHTC or other forms of public subsidy, the Lender must ensure that the Borrower has demonstrated experience in owning comparable regulated and subsidized properties and assess the Borrower's handling of any adverse circumstances.
2. the geographic area of business involvement.
3. the length of time of the principal's involvement with development, ownership and operation of residential healthcare facilities.
4. past roles performed by each principal in the residential healthcare business.

Each resume should demonstrate the level of experience needed to successfully complete the development of the proposed project. The Lender should identify new Borrowers whose primary business is not healthcare facility development or operations, that have little residential healthcare experience, or that are new to a particular market or state regulatory environment. It may be necessary to inspect a sample of the new Borrower's real estate holdings to determine the quality of the assets and management of the Borrower's existing portfolio. The Lender should explain any identified risks in the Borrower's existing



portfolios. The Lender may require that the Borrower bring in additional members to the development team to satisfy the experience requirements.

K. Any principal found to have an outstanding violation of the Fair Housing Act by the final determination of an administrative agency or court is ineligible under this section, unless the principal is operating under a remedial order or agreement.

## 6.2

## Participant Financial Review

A. Financial statements give a picture of the financial position of an individual or a /company at a certain point in time and provide: historical information for measuring and evaluating the financial performance of a principal or a firm, and advance warning of financial problems. Lenders should use the information in financial statements to determine if the Borrower, Operator, parent of the Operator and/or their principals have the financial capacity to develop, build and complete and operate the project, and whether the general contractor has the ability to deliver the project based on their respective:

1. past financial condition;
2. present liquidity;
3. projected future financial capacity.

The Lender must complete a financial review to determine the amount of funds available for investment in the project by performing an analysis of the working capital for a proposed project. Working capital is the difference between current assets and current liabilities and may be used to purchase assets, pay off debt and make up deficits from operations. The financial analysis also determines which non-pledged, unsecured assets can be readily hypothecated to secure the proposed FHA-insured loan.

B. **Exhibits:** The Borrower, Operator, parent of the Operator, and general contractor must furnish current financial statements with supporting schedules as part of the application for commitment processing.

*Note: For new construction, substantial rehabilitation, and blended rate projects the firm commitment application must include the last three (3) full years and year-to-date financial statements for the party who will be responsible for providing the financial requirements for closing and beyond. The Lender Narrative must also include a discussion on the available working capital of this party and the party's ability to support the project over the long term. In cases where a group of individuals come together on*

one project to meet the cash requirement, a HUD-92417, Personal Financial and Credit Statement, covering one full year for each member of the group will be satisfactory.

1. Individuals must submit either:

- a. a complete Personal Financial and Credit Statement (Form HUD-92417):
  - i. the spouse of married sponsors or principals must also sign the form.
  - ii. if a spouse's signature cannot be obtained, the principal must prepare the form reflecting only those assets that are solely in the principal's name and any liability, including those joint liabilities, for which the principal is responsible; or
- b. a substitute statement that contains, at a minimum, the information contained on the Personal Financial and Credit Statement. The statement must contain the following certifications and criminal warning:

*I HEREBY CERTIFY that the foregoing figures and statements contained herein submitted by me as agent of the Borrower [owner] for the purpose of obtaining mortgage insurance under the National Housing Act are true and give a correct showing of \_\_\_\_\_'s (Name of Borrower or owner) financial position as of \_\_\_\_\_ (date of financial statement). Signed this \_\_\_\_ day of \_\_\_\_\_, 20\_\_\_\_. Signature of authorized agent with name printed or typed under signature \_\_\_\_\_.*  
*Warning – HUD will prosecute false claims and statements. Conviction may result in criminal and/or civil penalties. (18 U.S.C. 1001, 1010, 1012; 31 U.S.C. 3729, 3802)*

For married individuals, the spouse also must sign the certification.

2. Business entities must submit separate statements and supporting documents, set forth below, for the last three (3) years or the length of their existence. If the entity has been in existence less than three (3) 3 years, an authorized officer of the organization must provide the statements and supporting documents with a signed statement that there has been no material adverse change since the date of the statements.

- a. Balance Sheet that:
  - i. provides a breakdown of current and non-current assets;
  - ii. identifies restricted and non-restricted funds;
  - iii. provides a breakdown of current and non-current liabilities;
  - iv. identifies the current portion of long-term debt; contingent liabilities, including debts under secured or unsecured lines of credit or letters of credit, personal guaranties, obligations to limited partnerships and other obligations payable in the future, including the amount and duration of the obligation; and

- 416 v. lists details of any factors that may materially affect the Borrower's or  
417 sponsor's financial position now or during the term of the proposed  
418 FHA-insured mortgage.
- 419 b. Income and expense statement that reflects:
- 420 i. income from normal operations;  
421 ii. investment income;  
422 iii. other income; and  
423 iv. total expenses.
- 424 c. If the financial statements are audited, a statement of changes in financial  
425 position; or if a fund accounting system is used, a statement of changes in fund  
426 balances, and all notes.
- 427 d. Supporting Schedules:
- 428 i. an aging schedule of accounts receivable that provides the name, type  
429 of account (trade, affiliate, employee, relative or other), payment  
430 terms, amount and aging information.
- 431 ii. an aging schedule of notes receivable that provides the name, type of  
432 account, payment terms, maturity date, current portion (due within one  
433 (1) year or one operating cycle of the business, whichever is less), past  
434 due amounts and non-current amounts.
- 435 iii. schedule of pledged assets, if applicable, identifying each pledged  
436 asset, the amount pledged and the offsetting liability.
- 437 iv. schedule of marketable securities that provides: name, number of  
438 shares, current market values as of the date of the statement, and the  
439 exchange where the shares are listed.
- 440 v. schedule of accounts payable that provides: name, type of account (trade,  
441 affiliate, employee, relative or other), payment terms, amount and aging  
442 information.
- 443 vi. schedule of notes and mortgages payable that provides: name, type of  
444 account, payment terms, maturity date, current portion (due within one  
445 (1) year or one operating cycle of the business, whichever is less), past  
446 due amounts and non-current amount.
- 447 vii. schedule of legal proceedings, if applicable.
- 448 viii. in addition to the applicable schedules set forth in subparagraphs 1-7  
449 above, general contractors must submit a schedule of jobs (work) in  
450 progress that identifies, for each job, the:
- 451 a. original contract price;  
452 b. construction start date;  
453 c. construction completion date; and  
454 d. percentage of completion.  
455 e. combined or consolidated financial statement(s), if applicable.
- 456 e. Other financial data necessary to determine the financial responsibility and  
457 capacity of the Borrower, Operator, parent of the Operator and their respective  
458 principals, and the general contractor,

- 459 f. The certification must be signed and dated by an authorized official of the  
460 company. The certifications must reference the name of the business and the  
461 date of the financial statement(s).  
462
- 463 3. **Section 223(f) project financial statements:** The proposed Borrower must submit  
464 financial statements for the last three (3) fiscal year of the project and if more than  
465 three (3) months have expired since the closing date of the financial statements, a  
466 year-to-date balance sheet and operating statement. If financial statements are not  
467 available due to circumstances beyond the Borrower's control, the Borrower must  
468 submit:
- 469 a. evidence satisfactory to the Lender that the financial statements are not  
470 obtainable;
  - 471 b. project financial statements that are available including an owner-certified  
472 balance sheet and operating statement and
  - 473 c. in all cases, the past three (3) years of tax returns for the property and the  
474 borrower entity.  
475
- 476 4. The Borrower must certify any financial statement or balance sheet and operating  
477 statement, each of which must include the criminal warning set forth in Section  
478 6.2.B.1.b(3) above.  
479
- 480 C. If the financial statements are not available, the Lender's case file must contain a statement  
481 from the Borrower that explains why all the required records are not obtainable and a  
482 memorandum from the Lender to the ORCF stating that the Lender has evaluated the  
483 Borrower's statement and agrees that the information is not available. **Processing financial**  
484 **statements and other documents:** A financial statement is considered current if it is no  
485 more than three (3) months old when the application is submitted by the Lender for firm  
486 commitment review. The Lender must determine financial stability and financial strength,  
487 unless the Borrower and sponsor is a public company with an investment-grade credit rating.  
488 The Lender's review should take the following factors into account :  
489
- 490 1. The credit investigation or other circumstances may warrant more current financial  
491 statements; therefore, the Lender should:
    - 492 a. assess the adequacy of each participant's liquidity and ability to provide  
493 immediate and ongoing support to the project, as well as to any asset that is in  
494 financial difficulty.
    - 495 b. review other sources of sponsor cash flow in the analysis, if the source and  
496 stability of the cash flow has been verified by reviewing historical tax returns.  
497 Interest income from notes receivable, real estate investment income, dividend  
498 income, and sponsor salaries should not be included.
    - 499 c. review audited or reviewed financial statements prepared by a CPA or IPA  
500 that are up to one (1) year old. Audited or reviewed statements must be  
501 supplemented with updated interim financial statements and supporting

documentation, which may be management-prepared, if more than six (6) months have lapsed since the closing date of the audited statement.

2. The Lender should review the financial statements of the participants and the general contractor to determine the amount of working capital available for the project. The net working capital should be adjusted to reflect contingent liabilities and the financial needs of other projects undertaken by the participants and the general contractor that are in the planning stage or under construction, as applicable.
3. The Lender should recommend that a loan be approved based on the “true net worth” of a participant rather than on working capital. Existing assets not working capital should be used to secure the FHA-insured mortgage loan. The Lender should review existing assets, loans and lines of credit. The Lender should require the participant to provide a commitment letter from a lending institution that states:
  - a. the rate, amount, term and conditions, if any, of the loan that the lending institution is willing to provide.
  - b. the date by which the commitment letter must be exercised; the date must extend at least to the anticipated date for initial endorsement.
  - c. the party that will be responsible for repayment of the loan or line of credit, if the commitment is exercised. Note that: repayment may not be an obligation of the borrower entity.The letter must include a certification indicating that the lending institution will not make any claim against the mortgaged property, mortgage proceeds, any reserve or deposit required by ORCF, or against the rents or other income from the mortgaged property for payment of the loan or line of credit. This certification must contain the criminal certification set forth in Section 6.2.B.1.b (3) above.
4. Funds provided by a parent company or affiliate of the participant require a certification from the board of directors or an authorized agent that specifies the amount of funds that the parent company or affiliate will commit to the project. The Lender should determine the availability of funds from the parent company or affiliate And consider whether:
  - a. individual corporations have any excess operating capital.
  - b. the laws under which the entity is incorporated or its exiting lenders permit:
    - i. withdrawals, loans or advances to owners or sponsors;
    - ii. stock investment in affiliated corporations; and
    - iii. guarantee of debts of associated corporations.
5. Letters of intent and letters of credit cannot be used to establish financial capability. At initial endorsement, however, letters of credit may be substituted for cash to set up many of the escrows required at initial and final endorsement, or during construction. If a participant draws down cash at initial closing to satisfy escrow requirements, a letter of credit cannot be substituted to establish the same escrow requirements.



- 545
- 546 6. Individuals are prohibited from submitting financial statements as a participant and
- 547 then abandoning the project and the Borrower after the firm commitment is issued.
- 548 The Lender should require a certified statement from the participant stating the
- 549 participant's commitment to the project and specifying the amount of funds that will
- 550 be reserved for contingent needs through final closing and sustaining occupancy.
- 551
- 552 7. The submission of a financial statement that is used to influence Federal Officials
- 553 concerning a mortgage insurance risk determination when the participant does not
- 554 plan a continuing relationship with the Borrower could result in appropriate sanctions
- 555 being taken against the sponsor including suspension or debarment.
- 556
- 557 8. General Contractor with adequate capital: The general contractor's adjusted working
- 558 capital position should equal five percent (5%) or more of the estimated construction
- 559 contract for the project.
- 560
- 561 If the general contractor does not have an acceptable working capital position, the
- 562 general contractor's fixed assets may be hypothecated. The general contractor's
- 563 ability to obtain a performance and payment bond does not negate or lessen this
- 564 requirement.
- 565 a. The Lender should review the working capital that the general contractor has
- 566 available for other projects in construction.
- 567 b. If the general contractor does not have an acceptable working capital position
- 568 or sufficient fixed assets that can be hypothecated, a joint venture may be
- 569 established with a general contracting firm that is financially stronger,
- 570 provided that, the combined working capital of the firms equals at least 5% of
- 571 all construction contracts that the firms have in construction and
- 572 development.
- 573
- 574

## 6.3

### Evaluating Non-profit Borrowers and Participants

- 575
- 576 A. **General:** Non-profit Borrowers (whether national, regional, or local) must have the
- 577 experience and financial strength appropriate for the development and ownership of the
- 578 proposed property. This section of the Handbook sets forth the criteria for making an
- 579 evaluation of the experience and strength of non-profit Borrowers. The non-profit Borrower
- 580 being evaluated may not have equal strength in all categories. In transactions where the
- 581 ownership structure involves multiple entities performing different functions, the Lender
- 582 should evaluate the non-profit Borrower and each of the other entities and their capacity to
- 583 perform a particular function (e.g., ownership, property management, acquisition,



development, resident services or asset management). Entity participants should have a prior acceptable history of successful development, ownership and management of assets that are similar in size, and complexity as the proposed project. Therefore, only the criteria for the areas for which the non-profit entity has direct responsibility or authority should be reviewed during the evaluation process. The Lender must include in the application:

1. the Developer's Agreement or any other document which shows the relationship and responsibilities of all parties associated with the transaction.
2. the housing consultant's contract, if applicable.
3. a memorandum of findings and recommendations which includes:
  - a. a description of the relationship between the non-profit and any profit-motivated entities involved in the transaction;
  - b. the determination of eligibility or ineligibility of the non-profit Borrower/sponsor must be approved by the ORCF Underwriter.
4. Lender's determination of experience and financial capacity of the non-profit Borrower and/or participants should include, but is not limited to, the following documentation:
  - a. a detailed explanation of the motivation for sponsoring the project including a history of the organization's involvement in multifamily housing;
  - b. a copy of the Borrower's charter and bylaws and all amendments;
  - c. a copy of any ruling denying tax exemption;
  - d. a verification from the Internal Revenue Service of the Borrower's tax-exempt status as a 501(c)(3) organization. If a ruling is pending, an explanation of the application's legal status;
  - e. a list of corporate officers or officers of the board of directors of the sponsoring non-profit with decision-making authority over the subject property, including their titles or positions, addresses, and individual social security numbers;
    - i. resumes for all principals and staff who will actively take part in the development of the proposed project
    - ii. current financial statement (balance sheet, profit and loss statement, and supporting schedules) as well as financial statements for the past three (3) years. If available, audited statements should be submitted. Financial statements should conform with the following:
    - iii. if the Borrower has existed less than three (3) years, the financial statements must be submitted from the date the group was formed.
    - iv. Statements must identify restricted and unrestricted assets (liquidity) along with the related liabilities and must show no material, unmitigated contingent liabilities.
    - v. an officer of the sponsoring non-profit must sign the financial statements.

- 627 vi. all statements must contain the certification of truth and accuracy and  
628 criminal certification identified in Section 6.2.B.1.b above. This  
629 certification must reference the name of the sponsor and the date of the  
630 financial statements.
- 631 vii. a signed written resolution of the non-profit's directors or trustees,  
632 acknowledging the responsibilities and obligations of sponsorship and  
633 continuing ownership, and that the subject proposal reflects the will of  
634 the membership.
- 635 viii. information contained in Section 6.1.K if the participant or any officer  
636 has a prior federal default or claim.
- 637 f. a detailed statement of the arrangements made or proposed for the following  
638 (listing principals involved, their relationship to the non-profit Borrower or  
639 other participant, the terms of the arrangements and the circumstances  
640 surrounding each):
- 641 i. land on which the project will be built  
642 ii. project construction, including selection of general contractor,  
643 subcontractors, and architect  
644 iii. legal and consulting services.  
645 iv. project financing, including any discounts.
- 646
- 647 5. The non-profit sponsor must have diverse and stable funding sources with recurring  
648 revenue and, if required, a proven record of raising sufficient funds to meet its  
649 operating needs. The Lender must identify whether the non-profit sponsor's primary  
650 funding sources are from fees on development projects or from sources such as public  
651 funding, public contracts, grants or donations that may be subject to budget or  
652 funding constraints.
- 653 a. ORCF underwriter review stage: ORCF will review whether the non-profit  
654 Borrower is qualified to start, complete and operate a project under the  
655 insured loan programs and determine that all of the following criteria are  
656 satisfied:
- 657 i. the non-profit Borrower is acting on its own behalf and is not, either  
658 knowingly or unwittingly, under the influence, control, or direction of  
659 any outside party seeking to derive a profit or gain from the proposed  
660 project (such as a landowner, real estate broker, contractor, architect,  
661 attorney, or consultant);
- 662 ii. the non-profit Borrower has continuity and a serious long-term  
663 commitment to supply housing for the intended resident population;
- 664 iii. the non-profit Borrower has continuity;
- 665 iv. the non-profit Borrower has strong roots in the neighborhood and local  
666 community and a good reputation for reliability, service, and  
667 commitment to the people for whom the housing is to be built;

- 668 v. the board of directors demonstrates ties to the local community served  
669 by the non-profit and includes representatives on the board from the  
670 local business community; and  
671 a. the non-profit Borrower must fully understand the  
672 responsibilities and obligations of  
673 b. developing a housing project and continuing its successful  
674 operation. This should be evidenced by:  
675 i. general knowledge of the factors that contribute to a  
676 project's success or failure;  
677 ii. familiarity with applicable healthcare facilities; and  
678 iii. prior successful experience developing, owning, and  
679 operating a healthcare facility similar to the subject.  
680 b. The Borrower must acknowledge, by a resolution passed by the majority of its  
681 directors or trustees, the responsibilities and obligations of sponsorship to  
682 develop and manage the project. The non-profit Borrower must not have any  
683 unresolved or recent internal control or compliance findings; unresolved  
684 issues of integrity; or conflict of interest.  
685 c. The Borrower and its principals must be reliable based on:  
686 i. reputation and past performance; and  
687 ii. success and the extent of previous experience, including the type of  
688 services furnished (financial, management, etc.), in providing senior  
689 housing or related social services.  
690 iii. The Borrower is providing or has arranged for the professional and  
691 management skills essential to the successful start, development,  
692 completion, and operation of the proposed project.  
693  
694 **B. Credit investigation:** The Lender must determine what individuals and entities have  
695 decision-making and operational authority over the project and provide an in-depth written  
696 analysis on the aspects of the mortgage credit review in the Lender Narrative. To conduct  
697 this credit investigation the Lender must:  
698  
699 1. order data and/or commercial credit reports on the sponsor and Borrower, if formed,  
700 and residential credit reports for the officers of the borrower entity to determine basic  
701 acceptability of credit reputation and previous experience. A credit review of  
702 individual members of non-profit board of directors is not required unless a member  
703 is also a board officer;  
704  
705 2. check for the existence of any delinquent federal debt;  
706  
707 3. check that the Borrower and other participants have no unresolved issues related to  
708 payment history and credit references;  
709  
710 4. analyze financial data to determine:

- 711 a. the amount of cash and liquid assets available for investment in the project  
712 b. whether the non-profit entity has used prudent judgment in its past and present  
713 business affairs;  
714 c. overall financial condition of the non-profit entity, particularly whether the  
715 financial statements indicate that income will be sufficient to meet the  
716 expenses incurred by the group and  
717 d. check for the presence of multiple fund accounts, such as general funds and  
718 building funds that are commonly maintained by many large non-profit  
719 organizations. The Lender should be aware of interfund receivables and  
720 payables that cancel each other and must not consider restricted-use funds in  
721 the analysis. The Lender should review the public records section of the  
722 credit report to eliminate assets that were used as collateral for secured  
723 borrowings.  
724
- 725 5. Carefully review the ability of the sponsoring organization to undertake a project of  
726 the size and complexity of the proposed project.  
727
- 728 6. Review the developer's fee. Non-profits may earn a developer's fee on a new  
729 construction, substantial rehabilitation, or blended rate proposal.  
730 *Note: The HUD Underwriter may check with applicable ORCF Account Executives*  
731 *or Multifamily Asset Management offices in the jurisdiction that the non-profit has*  
732 *done or now does business in order to ascertain the past experience and performance*  
733 *of the non-profit.*  
734
- 735 C. **Non-profit sponsor and a profit-motivated borrower entity:** A non-profit sponsor may  
736 establish a profit-motivated borrower entity for the purpose of owning a tax credit project or  
737 obtaining distributions from surplus cash. The formation of the profit-motivated entity may  
738 be approved provided that:  
739
- 740 1. the HUD closing attorney determines that there is no legal impediment that would  
741 prohibit approval of the request;  
742
- 743 2. the non-profit agrees to comply with the terms and conditions of the non-profit  
744 regulatory agreement applicable to a profit-motivated entity;  
745
- 746
- 747 3. the non-profit is subject to the mortgage limitations applicable to a profit-motivated  
748 entity;  
749
- 750 4. a working capital deposit is required (not applicable to Section 232 refinance  
751 projects);  
752

- 753 5. a non-profit developer's fee is not paid with the proceeds of the FHA-insured  
754 mortgage loan;  
755
- 756 6. if the non-profit provides evidence that it has obtained exemption from real estate  
757 taxes, the tax exemption must run with the real estate and not with the type of  
758 sponsorship;  
759
- 760 7. the potential tax consequences, as well as the possible effect on the non-profit's  
761 Section 501(c)(3) status with the IRS is determined to be acceptable;  
762
- 763 8. the entity may not make distributions to any individual member or shareholder except  
764 as may be authorized by HUD in its sole discretion for purposes related to the mission  
765 of the sponsoring organization.